



**Review of South Carolina Electric & Gas
Company's Gas Rate Stabilization Act
Monitoring Report**



SOUTH CAROLINA OFFICE OF REGULATORY STAFF

**Review of South Carolina Electric & Gas Company's
Gas Rate Stabilization Act Monitoring Report
For the period ending March 31, 2018**

Pursuant to S.C. Code Ann. Sections 58-5-430 and 58-5-440

August 31, 2018

South Carolina Office of Regulatory Staff

1401 Main Street
Suite 900
Columbia, SC 29201
(803) 737-0800

Introduction

On February 16, 2005, the Natural Gas Rate Stabilization Act (“RSA”), S.C. Code Ann. § 58-5-400, was signed into law. The South Carolina Office of Regulatory Staff (“ORS”), in accordance with the RSA, conducted an examination of South Carolina Electric and Gas Company’s (“SCE&G” or “the Company”) Monitoring Report for the twelve-month period ended March 31, 2018 (“Review Period”). The examination was conducted for the purpose of determining the Company’s compliance with the provisions of the RSA.

Pursuant to the RSA, the Company must file Monitoring Reports with the Public Service Commission of South Carolina (“Commission”) and the ORS on or before the fifteenth of June. In Docket No. 2018-6-G, SCE&G filed its Monitoring Report with the Commission on June 15, 2018 (“Request”). The Company reported in its March 31, 2018 Monitoring Report an adjusted rate of return and return on common equity of 10.55% and 14.67%, respectively. The Company’s calculation of a reduction in revenue requirements totaled (\$18,737,191).

In accordance with the RSA, ORS’s audit reports are provided to the Commission, the Company, and made available to all interested parties no later than the first of September. ORS’s review of SCE&G’s Monitoring Report focused on the Company’s adherence to the RSA and applicable Commission Orders. This report details the results of ORS’s examination.

RSA Rates History

In accordance with the guidelines of the RSA, the Company is entitled to an adjustment in rates sufficient to achieve a return on common equity as set by previous Commission Order, currently 10.25%. Table 1 shows the requested and approved changes granted for several prior RSA filings and a comparison to the current filing.

Table 1:

Docket No.	Order No.	Amount Requested	ORS Proposed Revenue	Amount Granted	Approved Return on Equity	Rates Effective
2014-6-G	2014-821	(\$2,997,170)	(\$2,647,323)	(\$2,647,323)	10.25%	11/1/2014
2015-6-G	2015-731	\$0	\$0	\$0	9.85%	11/1/2015
2016-6-G	2016-704	\$4,386,695	\$4,086,147	\$4,086,147	10.25%	11/1/2016
2017-6-G	2017-623	\$9,022,098	\$8,633,538	\$8,633,538	10.25%	11/1/2017
2018-6-G	TBD	(\$18,737,191)	(\$19,716,936)	TBD	10.25%	11/1/2018

ORS Review

ORS examines the operating experience reported by the Company for the Review Period together with the associated revenue requirement calculations. The results of ORS's examination of the Monitoring Report and the underlying financial records through March 31, 2018, are contained in **Schedule 1**.

Schedule 1 presents the Company's operating experience, rate base and rates of return for the Review Period, and the accounting and pro forma adjustments which ORS has determined are necessary to normalize the Company's operations.

Utilizing the per book rate base of \$604,039,365 and income of \$60,114,859, a rate of return was calculated on per book operations of 9.95% with a corresponding return on common equity of 14.07%. ORS accounting and pro forma adjustments increased net income for return to \$63,637,820 and increased rate base to \$604,599,683. A rate of return of 10.53% and a return on common equity of 15.22% were computed by ORS. After the adjustments for the proposed margin decrease of (\$19,716,936), net income for return decreased to \$48,655,329. The rate of return on rate base computed by ORS after the adjustments for the proposed decrease is 8.05%. The return on common equity is 10.25%.

Schedule 2 presents an explanation of the accounting and pro forma adjustments ORS recommends for the Company's Monitoring Report to conform to S.C. Code Ann. §§ 58-5-430

and 58-5-440. For comparative purposes, the adjustments of both the Company and ORS are presented on Schedule 2.

The non-allowable expense adjustment proposed by ORS is (\$451,410). Below is a description of the categories of non-allowable expenses identified by ORS.

- Legal Expenses – Legal expenses with invoice detail redacted such that ORS could not verify the work performed.
- No supporting documentation – Expenses ORS selected for testing for which the Company did not provide any support.
- Insufficient documentation – Expenses ORS selected for testing for which the Company did not provide adequate support. Items were disallowed due to no list of attendees on sign-in sheet, no clear business purpose on agenda, no itemized receipt, no source documents other than voucher request, invoice provided does not agree to general ledger detail and unsigned contract/letter from third party.
- Sponsorships/Chamber of Commerce – Cost of sponsorships not directly related to gas operations and 50% of Chamber of Commerce expenditures.
- Incorrectly allocated to South Carolina Gas Operations – Expenses improperly allocated to South Carolina Gas Operations.
- Lavish Expenses – Expenses not considered necessary for ratemaking such as refreshments and meals for internal meetings and internal trainings.
- Parties, Banquets and Awards – Expenses associated with retirement parties and appreciation events.
- Emeritus Retainer Fees – Payments to former board members for honorary positions.

Table 2 provides a summary of the non-allowable expense adjustments made by ORS.

Table 2:

	Amount
SCE&G's Non-Allowable Expense Adjustment #20	(\$29,071)
<i>Additional Adjustments Proposed by ORS:</i>	
Legal Expenses	(\$338,553)
No supporting documentation	(\$18,779)
Insufficient documentation	(\$48,779)
Sponsorships/Chamber of Commerce	(\$402)
Incorrectly allocated to South Carolina Gas Operations	(\$5,183)
Lavish Expenses	(\$4,081)
Parties, Banquets and Awards	(\$604)
Emeritus Retainer Fees	(\$5,958)
ORS's Non-Allowable Expense Adjustment #20	(\$451,410)

Capital Structure

S.C. Code Ann. § 58-5-440 contains requirements for the March Monitoring Report and states, “(1) if the utility’s earnings exceed the upper end of the range established in the order, the utility shall calculate the reduction in revenue required to lower its return on equity to the midpoint of the range established in the order; or (2) if the utility’s earnings are below the lower range established in the order, the utility shall calculate the additional revenue required to increase its return on equity to the midpoint of the range established in the order.” The range is 9.75% to 10.75% with a midpoint of 10.25% return on equity.

Schedule 3 presents the calculation of the weighted cost of capital used by ORS in calculating the Company’s return on common equity both before and after ORS’s adjustments for the proposed margin decrease. The capital structure submitted by the Company did not reflect the actual capital structure based on the Company’s most recent Balance Sheet. The capital structure submitted by SCE&G was 46.87% Long-Term Debt and 53.13% Equity and the capital structure based on the Company’s Balance Sheet as of March 31, 2018 is 50.17% Long-Term Debt and 49.83% Equity. ORS recommends the capital structure as reflected in the March 31, 2018, SCE&G balance sheet be used for this period’s rate base calculation.

The rate base, as shown on Schedule 1, is allocated between long-term debt and common equity using the Company’s actual capital structure. The as adjusted amount of total income for return necessary to cover an embedded cost rate of 5.86% on long-term debt is computed to be \$17,775,001. The remainder of the total income for return of \$45,862,819 is income to common equity. This produced a return of 15.22% on common equity before the proposed decrease. The overall cost of capital after accounting and pro forma adjustments, prior to the proposed decrease, is 10.53%. The cost of capital after the proposed decrease equals 8.05%.

Tax Cuts and Jobs Act

In a letter dated January 24, 2018 filed in Docket No. 2017-381-A, SCE&G stated it would include the necessary pro forma adjustments in the RSA filing to reflect the impact of the 2017 Tax Cuts and Jobs Act (“Tax Act”). SCE&G proposed adjustments to annualize the excess deferred income tax impact, normalize test year revenues for the impact of the tax reserve estimate and annualize the current federal income tax rate. ORS does not propose further adjustments to the Company’s calculations.

Excess Income Tax

After the Tax Act was passed into law, the Company’s federal income tax rate decreased from 35% to 21%. From January 1, 2018 and continuing through October 31, 2018, the Company will have collected revenues from customers based on a 35% federal income tax rate. The Company calculated the value of excess tax revenue collected from January 1, 2018 through March

31, 2018 as \$3,893,151. This amount will be returned to customers using a Tax Reform Rate Rider beginning November 1, 2018.

The next RSA period will incorporate the remaining balance of the excess tax revenue collected from April 1, 2018 through October 31, 2018 to be returned to customers from November 1, 2019 through October 31, 2020.

Excess Deferred Income Taxes

The Company calculated the value of the Excess Deferred Income Taxes (“EDIT”) which was created by the Tax Act’s reduction of the federal income tax rate from 35% to 21% which reduced expected future income tax payments. The EDIT is approximately \$82,781,500 and is included as a reduction to the Company’s rate base. The Company proposed to split the EDIT into two categories to be amortized and returned to rate payers. The first category is related to unprotected deferred federal income taxes, which the Company has proposed to be amortized and returned to customers during a 5-year period. The second category is related to protected property, plant and equipment, which will be returned to customers utilizing the Average Rate Assumption Method described in the Tax Act. The total annual amortization of the unprotected and protected EDIT is approximately \$2,635,200.

Current Federal Taxes

The Company proposed to incorporate the change in the federal income tax rate from 35% to 21%. This resulted in a reduction of \$1,830,923 to the Company’s federal income tax expense.

Employee Incentive Plans

SCE&G adjusted its O&M expense to remove 50% of salary expense and associated payroll taxes for employee short-term and long-term incentives. SCE&G capitalizes a portion of employee incentives for work related to plant-in-service. ORS requested the Company identify the associated accounts and dollar amounts associated with capitalized employee incentives. The Company was unable to provide this information to ORS. Based on the information received from the Company, ORS was unable to reduce employee incentives included in plant-in-service. ORS requests the Commission require the Company, in future RSA filings, to record employee incentives capitalized as plant-in-service in an account other than Net Plant in Service such that employee incentives can be reviewed annually by ORS.

Rate Design and Allocation of Additional Revenue

S.C. Code Ann. § 58-5-440 states, “The proposed rate changes, filed by the utility, shall conform as nearly as is practicable with the revenue allocation principles contained in the most recent rate order.” ORS has reviewed and agrees that the Company’s proposed tariffs conform as nearly as practicable to the revenue allocation principles set out in the Company’s most recent rate

order, which is Commission Order No. 2005-619 in Docket No. 2005-113-G. If the Commission approves the findings of ORS's examination, the Company would then apply the change in revenue amount in proportion to the Company's Request using the same criteria. ORS will verify the new rates generate the approved revenue change.

Revenue Verification

ORS verified that the approved rates for April 1, 2017 through March 31, 2018 reflect actual revenues generated during the Review Period. Additionally, ORS verified the proposed revised tariffs in Exhibit B of SCE&G's proposed rate adjustments will generate a revenue reduction of (\$18,737,191). ORS's review determined the retail revenue target reduction is (\$19,716,936) instead of (\$18,737,191) as proposed by the Company (See Exhibit A of the Company's Request). ORS reduced the Company's Request by (\$979,745) or 5.23%. The results of ORS's examination are shown on Schedule 1.

Conclusions

ORS reviewed SCE&G's Monitoring Report and conducted an examination of the Company's books and records. ORS recommends the revenue reduction for SCE&G be (\$19,716,936).

RegulatoryStaff.SC.GOV

Office of Regulatory Staff

1401 Main Street
Suite 900
Columbia, SC 29201



Schedule 1

South Carolina Electric & Gas Company, Docket No. 2018-6-G
Operating Experience - Total Gas
For the Twelve-Month Period Ended March 31, 2018

<u>Description</u>	<u>Per Regulatory Books</u>	<u>Accounting & Pro Forma Adjustments</u>	<u>As Adjusted</u>	<u>Total Proposed Increase/ (Decrease)</u>	<u>Total After Proposed Increase/ (Decrease)</u>
<u>Operating Revenues</u>	\$ 421,336,443	\$ 6,138,455 (A)	\$ 427,474,898	\$ (19,716,936) (O)	\$ 407,757,962
<u>Operating Expenses:</u>					
O&M Expenses - Cost of Gas	217,311,051	0	217,311,051	0	217,311,051
O&M Expenses - Other	69,228,228	(402,506) (B)	68,825,722	0	68,825,722
Dep. & Amort. Expenses	30,563,901	5,077,751 (C)	35,641,652	0	35,641,652
Taxes Other Than Income	29,711,521	1,930,769 (D)	31,642,290	(100,024) (P)	31,542,266
State Income Taxes	1,843,949	(24,152) (E)	1,819,797	(980,846) (Q)	838,951
Federal Income Taxes	13,397,591	(3,905,005) (F)	9,492,586	(3,913,574) (R)	5,579,012
<u>Total Operating Expenses</u>	<u>362,056,241</u>	<u>2,676,857</u>	<u>364,733,098</u>	<u>(4,994,444)</u>	<u>359,738,654</u>
<u>Total Operating Income</u>	59,280,202	3,461,598	62,741,800	(14,722,492)	48,019,308
Customer Growth	1,046,657	61,363 (G)	1,108,020	(259,999) (S)	848,021
Interest on Customer Deposits	(212,000)	0	(212,000)	0	(212,000)
<u>Net Income for Return</u>	<u>60,114,859</u>	<u>3,522,961</u>	<u>63,637,820</u>	<u>(14,982,491)</u>	<u>48,655,329</u>
<u>Rate Base:</u>					
Gross Plant in Service	1,201,498,092	(653,408) (H)	1,200,844,684	0	1,200,844,684
Reserve for Depreciation	453,162,671	186,544 (I)	453,349,215	0	453,349,215
Net Plant in Service	748,335,421	(839,952)	747,495,469	0	747,495,469
Construction Work in Process	17,453,261	(592) (J)	17,452,669	0	17,452,669
Accum. Deferred Income Taxes	(92,737,900)	(493,112) (K)	(93,231,012)	0	(93,231,012)
Environmental Costs	10,840,609	0	10,840,609	0	10,840,609
Pension Deferral	6,814,333	0	6,814,333	0	6,814,333
OPEB's	(18,276,346)	(32,114) (L)	(18,308,460)	0	(18,308,460)
Tax Deferrals	(82,781,500)	1,976,400 (M)	(80,805,100)	0	(80,805,100)
Injuries & Damages	(1,192,502)	0	(1,192,502)	0	(1,192,502)
Materials & Supplies	19,695,989	0	19,695,989	0	19,695,989
Total Working Capital	8,653,529	(50,312) (N)	8,603,217	0	8,603,217
Prepayments	11,123,999	0	11,123,999	0	11,123,999
Average Tax Accruals	(14,235,440)	0	(14,235,440)	0	(14,235,440)
Customer Deposits	(9,654,088)	0	(9,654,088)	0	(9,654,088)
<u>Total Rate Base</u>	<u>604,039,365</u>	<u>560,318</u>	<u>604,599,683</u>	<u>0</u>	<u>604,599,683</u>
<u>Rate of Return</u>	<u>9.95%</u>		<u>10.53%</u>		<u>8.05%</u>
<u>Return on Equity</u>	<u>14.07%</u>		<u>15.22%</u>		<u>10.25%</u>

South Carolina Electric Gas Company, Docket No. 2018-6-G
Explanation of Accounting and Pro Forma Adjustments - Gas Operations
For the Twelve-Month Period Ended March 31, 2018

Schedule 2
1 of 2

Adj #	Description	Operating Revenues \$	Other O&M Expenses \$	Depreciation & Amortization Expenses \$	Taxes Other Than Income \$	State Income Taxes @ 5.0% \$	Federal Income Taxes @ 21% \$	Customer Growth \$	Gross Plant in Service \$	Reserve for Depreciation \$	Construction Work in Process \$	Accumulated Deferred Income Taxes \$	OPEB	Tax Deferrals \$	Working Capital \$
Accounting & Pro Forma Adjustments															
1	Annualize Wages, Benefits, and Payroll Taxes Per Company Per ORS		184,077 184,077		13,024 13,024	(9,855) (9,855)	(39,322) (39,322)								23,010 23,010
2	Incentive Compensation Adjustment Per Company Per ORS		(39,838) (74,746)		(14,283) (34,053)	2,706 5,490	10,797 21,905								(4,980) (9,343)
3	Remove Employee Clubs and Service Awards Per Company Per ORS			(13,038) (13,038)		652 652	2,601 2,601		(533,020) (533,020)	(214,565) (214,565)	(592) (592)				
4	Recognize Property Retirements, Depreciation Reserves Per Company Per ORS								(120,388) (120,388)	(120,388) (120,388)					
5	Recognize Property Additions/Adjustments, Plant In Service Per Company Per ORS								0 0		0 0				
6	Annualize Depreciation-Reserve Adjustment Per Company Per ORS			515,776 515,776		(25,789) (25,789)	(102,897) (102,897)			521,497 521,497					
7	Annualize Property Taxes Per Company Per ORS				1,920,658 1,920,658	(96,033) (96,033)	(383,171) (383,171)								
8	Customer Awareness Campaign Per Company Per ORS		(138,166) (138,166)			6,908 6,908	27,564 27,564								(17,271) (17,271)
9	Annualize Health Care Expenses Per Company Per ORS		(1,157,163) (514,310)			57,858 25,716	230,854 102,605								(144,645) (64,289)
10	Annualize Other Post-Employee Benefits Per Company Per ORS		42,790 42,790			(2,140) (2,140)	(8,537) (8,537)						(32,114) (32,114)		5,349 5,349
11	Annualize Insurance Expense Per Company Per ORS		(1,929) (1,929)			96 96	385 385								(241) (241)
12	Tax Effect of Annualized Interest Per Company Per ORS					(738) (824)	(2,943) (3,286)								

South Carolina Electric Gas Company, Docket No. 2018-6-G
Explanation of Accounting and Pro Forma Adjustments - Gas Operations
For the Twelve-Month Period Ended March 31, 2018

Schedule 2
2 of 2

Adj #	Description	Operating Revenues \$	Other O&M Expenses \$	Depreciation & Amortization Expenses \$	Taxes Other Than Income \$	State Income Taxes @ 5.0% \$	Federal Income Taxes @ 21% \$	Customer Growth \$	Gross Plant in Service \$	Reserve for Depreciation \$	Construction Work in Process \$	Accumulated Deferred Income Taxes \$	OPEB	Tax Deferrals \$	Working Capital \$
13	Pension - Current Expense Per Company Per ORS		(749,939) (749,939)			37,497 37,497	149,613 149,613								(93,742) (93,742)
14	WNA Amortization Per Company Per ORS			4,575,013 4,575,013		(228,751) (228,751)	(912,715) (912,715)								
15	Annualize Revenue Increase/(Decrease) Per Company Per ORS	2,245,304 2,245,304			12,154 11,390	111,658 111,696	445,513 445,666								
16	Tax Reform-Amortization of Excess Deferred Taxes Per Company Per ORS						(1,977,718) (1,977,718)					(493,112) (493,112)		1,976,400 1,976,400	
17	Tax Reform-Normalize Test Year Revenues Per Company Per ORS	3,893,151 3,893,151			21,074 19,750	193,604 193,670	772,480 772,744								
18	Tax Reform-Annualize Current Tax Expense Per Company Per ORS						(1,830,923) (1,830,923)								
19	Pipeline Integrity Management Amortization Per Company Per ORS		1,301,127 1,301,127			(65,056) (65,056)	(259,575) (259,575)								162,641 162,641
20	Remove Non-Allowable Expenses for Ratemaking Purposes Per Company Per ORS		(29,071) (451,410)			1,454 22,571	5,800 90,056								(3,634) (56,426)
21	Adjust for Customer Growth Per Company Per ORS							63,285 61,363							
Total Company Accounting & Pro Forma Adjustments		6,138,455	(588,112)	5,077,751	1,952,627	(15,929)	(3,872,194)	63,285	(653,408)	186,544	(592)	(493,112)	(32,114)	1,976,400	(73,513)
Total ORS Accounting & Pro Forma Adjustments		6,138,455	(402,506)	5,077,751	1,930,769	(24,152)	(3,905,005)	61,363	(653,408)	186,544	(592)	(493,112)	(32,114)	1,976,400	(50,312)
		(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)	(J)	(K)	(L)	(M)	(N)
Total Proposed Increase/(Decrease)															
22	Adjust Revenue, Taxes & Customer Growth Per Company Per ORS	(18,737,191) (19,716,936)			(101,424) (100,024)	(931,788) (980,846)	(3,717,836) (3,913,574)	(246,988) (259,999)							
Total Company Proposed Increase/(Decrease)		(18,737,191)	0	0	(101,424)	(931,788)	(3,717,836)	(246,988)	0	0	0			0	0
Total ORS Proposed Increase/(Decrease)		(19,716,936)	0	0	(100,024)	(980,846)	(3,913,574)	(259,999)	0	0	0			0	0
		(O)			(P)	(Q)	(R)	(S)							

South Carolina Electric & Gas Company, Docket No. 2018-6-G
Weighted Cost of Capital
For the Twelve-Month Period Ended March 31, 2018

Description	Capital Structure	Ratio	Regulatory Per Books			As Adjusted			After Proposed Increase/(Decrease)					
			Rate Base	Embedded Cost/Return	Overall Cost/Return	Income For Return	Rate Base	Embedded Cost/Return	Overall Cost/Return	Income For Return	Rate Base	Embedded Cost/Return	Overall Cost/Return	Income For Return
Long-Term Debt	\$ 4,928,770,000	50.17%	\$ 303,046,549	5.86%	2.94%	\$ 17,758,528	\$ 303,327,661	5.86%	2.94%	\$ 17,775,001	\$ 303,327,661	5.86%	2.94%	\$ 17,775,001
Preferred Stock	100,000													
Common Equity	4,894,433,506	49.83%	300,992,816	14.07%	7.01%	42,356,331	301,272,022	15.22%	7.59%	45,862,819	301,272,022	10.25%	5.11%	30,880,328
Totals	\$ 9,823,303,506	100.00%	\$ 604,039,365		9.95%	\$ 60,114,859	\$ 604,599,683		10.53%	\$ 63,637,820	\$ 604,599,683		8.05%	\$ 48,655,329